

HJ
793
.S5
pt.2

NUNC COGNOSCO EX PARTE



TRENT UNIVERSITY
LIBRARY

**BULLETIN OF THE DEPARTMENTS OF HISTORY AND
POLITICAL AND ECONOMIC SCIENCE IN QUEEN'S
UNIVERSITY, KINGSTON, ONTARIO, CANADA.**

NO. 29, OCTOBER, 1918

CANADIAN FEDERAL FINANCE—II.

BY

O. D. SKELTON

The Jackson Press, Kingston

BULLETIN OF THE DEPARTMENTS OF HISTORY AND
POLITICAL AND ECONOMIC SCIENCE IN QUEEN'S
UNIVERSITY, KINGSTON, ONTARIO, CANADA.

- No. 1, The Colonial Policy of Chatham, by W. L. Grant.
- No. 2, Canada and the Most Favored Nation Treaties, by
O. D. Skelton.
- No. 3, The Status of Women in New England and New France,
by James Douglas.
- No. 4, Sir Charles Bagot: An Incident in Canadian Parliam-
entary History, by J. L. Morison.
- No. 5, Canadian Bank Inspection, by W. W. Swanson.
- No. 6, Should Canadian Cities Adopt Commission Govern-
ment, by William Bennett Munro.
- No. 7, An Early Canadian Impeachment, by D. A. McArthur.
- No. 8, A Puritan at the Court of Louis XIV, by W. L. Grant.
- No. 9, British Supremacy and Canadian Autonomy: An Ex-
amination of Early Victorian Opinion Concerning
Canadian Self-government, by J. L. Morison.
- No. 10, The Problem of Agricultural Credit in Canada, by
H. Michell.
- No. 11, St. Alban in History and Legend: A Critical Examina-
tion; The King and His Councillors: Prolegomena to
a History of the House of Lords, by L. F. Rushbrook
Williams.
- No. 12, Life of the Settler in Western Canada Before the War
of 1812, by Adam Shortt.
- No. 13, The Grange in Canada, by H. Michell.
- No. 14, The Financial Power of the Empire, by W. W. Swanson.
- No. 15, Modern British Foreign Policy, by J. L. Morison.
- No. 16, Federal Finance, by O. D. Skelton.
- No. 17, Craft-Gilds of the Thirteenth Century in Paris, by F.
B. Millett.
- No. 18, The Co-operative Store in Canada, by H. Michell.
- No. 19, The Chronicles of Thomas Sprott, by Walter Sage.
- No. 20, The Country Elevator in the Canadian West, by W. C.
Clark.
- No. 21, The Ontario Grammar Schools, by W. E. Macpherson.

CANADIAN FEDERAL FINANCE—II.

1. *The Task Before Us.*

IN the current fiscal year the Dominion government is faced with the task of raising for our civil budget, for our direct war expenditure, and for loans to our ally, Great Britain, over \$980,000,000. In a world that talks in billions, this may not seem a great amount. Compared with the \$24,000,000,000 to be voted by the United States or the \$14,000,000,000 of the British budget, it seems little. Compared with the greatness and the urgency of the cause for which we fight, it is as dust in the balance. But compared with peace-time budgets, and with peace-time resources, as we judged them, it is colossal. It means that in a single year we must raise a sum greater than the total expenditure of the Dominion, on current or consolidated fund account, during the whole generation from 1867 to 1900. It means that we must raise in a year practically the amount that the federal government of that populous, wealthy and certainly not over-economical country, the United States, was spending before the war. It means that this task is to be faced by a country which even before the war had been spending lavishly and taxing heavily: with one-fourteenth the population of the United States, we were spending on federal purposes one-sixth as much, while the total tax-bill of the average Canadian was, contrary to current opinion, clearly heavier than that of the average British tax-payer.¹

The task before us, then, is so great as to warrant the close and constant attention not merely of the responsible authorities, the powers that be at Ottawa, but of every citizen in the Dominion. In a previous article, published two years ago,² an attempt was made to contribute to the discussion of the question by a summary of the facts as to federal revenue and expenditure, and a review of the possible sources of revenue, leading to an advocacy of a federal income tax. That

¹*Federal Finance*, I p. 3.

²*Federal Finance*, I, in *Queen's Quarterly*, July, 1915, and printed as *Bulletin* No. 16 of the Departments of History and of Political and Economic Science, Queen's University.

essential reform, then scouted in official quarters, has now become an important and doubtless a permanent feature of our fiscal system. Other issues have risen, and some of the old issues are still before us. In the present article, the purpose is to summarize the facts as to our war finance, to comment briefly on the methods followed, and to consider, still more briefly, how the burdens of the future may be met.

2. *War-Time Income and Outlay.*

The total expenditure of the Dominion for war purposes, including outlays in France and England as well as in Canada, but not including advances to Allies, up to March 31, 1918—the end of the fiscal year 1917-18—was \$879,000,000. The total up to August 1, 1918, that is, for four complete years of war, will be practically a billion dollars. The exact official figures follow:

Canadian War Expenditure, 1914-18.

Fiscal year 1914-15 (eight months of war	\$ 60,750,476 01
“ 1915-16	166,197,755 47
“ 1916-17	306,488,874 63
“ 1917-18 (returns not yet complete).....	343,834,688 85
	<hr/>
	\$877,271,794 96
“ 1918-19, to Aug. 1, 1918 (returns not yet complete)	113,720,046 60
	<hr/>
Total for four years of war.....	\$990,991,841 56

In the four fiscal years 1914-15 to 191-18, the total expenditure of the Dominion for civil purposes was approximately three-quarters of a billion. This covers both the expenditure on current or consolidated fund account, and the capital expenditure, including construction of railways and other public works, along with railway subsidies, loan discount and minor charges. A detailed table follows:

	Consolidated Fund	Capital and Other	Total
Fiscal year 1914-15 ..	\$135,523,206 54	\$ 51,824,843 78	\$187,348,050 32
“ 1915-16 ..	130,350,726 90	43,154,020 12	173,504,747 02
“ 1916-17 ..	148,599,343 23	43,114,960 42	191,714,303 65
“ 1917-18, approx.	176,923,645 61	57,799,611 75	234,723,257 36
	<hr/>	<hr/>	<hr/>
	\$591,396,922 28	\$195,893,486 07	\$787,290,358 35

The total expenditure in the four fiscal years 1914 to 1918 is therefore as follows:

Fiscal years 1914-18, War Expenditure	\$ 877,271,794 96
“ “ Consolidated Fund	591,396,922 28
“ “ Capital and Other	195,893,436 07
	<hr/>
	\$1,664,562,153 31

During the same period the consolidated fund revenue, that is, receipts from other sources than loans, and including taxes and income from lands and public utilities, was about \$800,000,000, or slightly less than half the total expenditure. In the tables below the excess of expenditures over receipts is shown for each year:—

SUMMARY OF REVENUE AND EXPENDITURES, 1914-1918.

Fiscal Year 1914-1915.

Consol. Fd. Receipts 133,073,481 73	Consol. Fd. Expend. 135,523,206 54
Sinking Fund . . . 1,645,811 53	Capital & other Exp. 51,824,843 78
Net addition to Debt 113,379,233 07	(incl. subsidies & loan discounts).
	War Expenditure . . 60,750,476 01
<hr/>	<hr/>
\$248,098,526 33	\$248,098,526 33

Fiscal Year 1915-16.

Consol. Fd. Receipts 172,147,838 27	Consol. Fd. Expend. 130,350,726 90
Other Receipts . . 1,555 30	Capital & other Exp. 43,154,020 12
Sinking Fund . . . 1,773,021 11	War Expenditure . 166,197,755 47
Net addition to Debt 165,780,087 81	
<hr/>	<hr/>
\$339,702,502 49	\$339,702,502 49

Fiscal Year 1916-17.

Consol. Fd. Receipts 232,701,294 00	Consol. Fd. Expend. 148,599,343 23
Sinking Fund . . . 1,471,697 50	Capital & other Exp. 43,114,960 42
Net addition to Debt 264,030,126 78	War Expenditure . 306,488,814 63
<hr/>	<hr/>
\$498,203,118 28	\$498,203,118 28

Fiscal Year 1917-18 (approx.)

Consol. Fd. Receipts 260,566,379 83	Consol. Fd. Expend. 176,923,645 61
Sinking Fund . . . 3,183,492 66	Capital & other Exp. 57,799,611 75
Net addition to Debt 314,808,073 72	War Expenditure . 343,834,688 85
<hr/>	<hr/>
\$578,557,946 21	\$578,557,946 21

TOTAL INCREASE OF DEBT.

Net Public Debt, March 31, 1914	\$	335,996,850	14
Increase, Fiscal year 1914-15.....	\$	113,379,233	07
“ “ 1915-16		165,780,087	81
“ “ 1916-17		264,030,126	78
“ “ 1917-18		314,808,073	72
		<hr/>	
	\$	857,997,521	38

Net Debt, March 31, 1918, approximate\$1,193,994,371 52

It will be noted that in the first year, 1914-15, the revenue, so far from providing a surplus to be applied on war expenditure, did not even cover the civil budget, and that a sum nearly double the amount spent on the war was added to the national debt. In the second year, civil receipts and expenditures balanced, leaving the whole war outlay to be met by borrowing. In the third and fourth years, there were substantial surpluses over all civil expenditure, making it possible to apply \$41,000,000 in one year and \$26,000,000 in the other, to the principal of the war outlay. Taking the four years together, there was a surplus of revenue over all civil expenditure of only \$12,000,000. In other words, of the total principal of the war outlay to April 1, 1918, \$877,000,000, only \$27,000,000, or less than two per cent. has been met out of current revenues. In the past year a better showing was made, the surplus available for application on war outlay being \$26,000,000, or 8 per cent. In 1918-19, it is estimated that the surplus will be \$40,000,000, or 9 per cent. of the war outlay. It must be borne in mind that a heavy and rapidly increasing burden of war interest and pensions, about \$70,000,000 in all, was met out of current revenue in this period. On the other hand, the civil budget has been relieved of the greater part of ordinary military and naval expenditure, running about \$15,000,000 a year in peace-time.

It may be suggested that all revenues in excess of consolidated fund expenditure should be considered as a surplus applicable on the principal of the war outlay, and that we should consider that a portion of our increased debt has really been incurred for capital and other expenditure not ordinarily to be met out of current income. There is, of course, a case for the contention that capital, non-recurring expenditure should be

met by loans, not from current revenue. When the capital outlays recur year after year, however, this contention loses force. In any case, the practical point is that in normal pre-war years only a part, or none at all of the capital expenditure required to be met by loans. Ordinary revenue of late years had covered both current and capital outlays, including the cost of railway construction and subsidies. The debt in 1914 was less than in 1910 and only \$100,000,000 more than it was a quarter century before, or an average shortage of only \$4,000,000 a year. This fact indicates the basis to be taken in comparison of war with pre-war finance.

War Time Loans.

The funds to meet these larger outlays have come from loans and from taxes—the revenues from public works merely offsetting at best the current expenditure in these services.

The loans have taken the following forms:

1. *Temporary advances* from Canadian banks, usually through the sale of Treasury Bills, repaid out of public loans.

2. *Debenture Stock* issued in sums of \$500 and multiples thereof bearing 5 per cent. interest, and maturing in October, 1919, holders having the privilege of surrendering at par in payment on war loan issue.

3. *Public Loans* in Great Britain, the United States, and Canada. A brief summary follows:

(a) *Loans floated in United Kingdom:*

March, 1915, 4½% at 99½, 5-10 years\$ 23,332,500

(b) *Loans floated in the United States:*

August, 1915, 5%, one year notes at 100, two year notes at 99½, less commission 45,000,000

March, 1916, 5%, 5-10-15 years at 99.56, 99.12, and 94.94 75,000,000

August, 1917, 5% two year notes at 98..... 100,000,000

Summer, 1918, loan made in New York..... 65,000,000

(c) *Loans floated in Canada:*

November, 1915, 5%, 10 years, at 97½ (24,862 subscribers) 100,000,000

September, 1916, 5%, 15 years, at 97½ (34,526 subscribers) 100,000,000

<i>March</i> , 1917, 5%, 20 years, at 96 (41,263 subscribers)	150,000,000
<i>November</i> , 1917, 5½%, 5-10-20 years at 100 (802,000 subscribers)	400,000,000

4. *Advances from British government.* Canada is bearing the full cost of maintaining her forces in the field. To cover the expenditures made directly by the Canadian government in Great Britain and France, Canada has borrowed on open account from the British government. Further, to meet the cost of supplies and munitions served to our troops in the field from British sources, Canada has agreed to pay to the British government the sum of 6s. 3d. (now raised to 9s. 4d.) per man per day. On the other hand, the Canadian government advances to the British government a large part of the funds required for its purchases of munitions and other supplies in Canada—the balance coming from loans from the Canadian Banks on Treasury Bills, and from the United States government. In addition, Canada in 1916 paid some \$107,000,000 on account by delivering to British government dollar bonds for that sum, to be used as collateral for a loan in New York. For the first two years the balance in this open account was against Canada; since then it has been in our favour. On March 31, 1918, the Canadian government had lent Great Britain \$100,000,000 more than it had borrowed; by August 1, 1918, the net indebtedness of Britain to Canada was \$140,000,000.

5. *War Savings Certificates.* Since Jan. 1917, certificates of \$20, \$50 and \$100, repayable in three years from date of issue, and sold at \$21.50, \$43.00 and \$86.00 respectively, have been offered for sale in Canada. Later \$10 certificates were placed on sale. By March 31, 1918, some \$12,500,000 had been sold.

6. *Note Issue.* In the early months of the war the government secured a forced loan without interest, by the issue of inconvertible paper. The Finance Act, 1914, increased the limit of Dominion note issue, below which only a 25 per cent. gold backing is required, from \$30,000,000 to \$50,000,000, thus giving \$15,000,000 free. By order-in-council, in these same first months of the war, confirmed later by legislation, an issue of \$16,000,000 in Dominion notes was made to the Cana-

dian Northern and Grand Trunk Pacific against pledged securities. No recourse has since been made to this facile but dangerous method of financing.

War Time Taxes.

Turning next to taxes, we find customs and excise still holding their predominant place in Canadian finance. A heavy decrease in customs duties in 1914-15—which had set in before the war and was due as much to business depression as to war disturbance—was offset later by reviving trade and increased duties. Excise duties, mainly on liquors and tobacco, kept up well, in spite of the advance of prohibition, until the close of the year 1917-18. A relatively small sum has been obtained from the war taxes introduced in April, 1915, one-third of it from direct taxes on banks, fire insurance and trust and loan companies, and the remainder from indirect stamp or consumption taxes on railway tickets, telegraph messages, cheques, money orders, patent medicines, etc. The Business Profits Tax has yielded a revenue for only two years. The Income Tax has not yet been levied. A summary in round numbers follows:

	Customs	Excise	Business Profits	Other War Taxes
1914-15	76,000,000	21,000,000		100,000
1915-16	98,000,000	23,000,000		3,600,000
1916-17	134,000,000	24,000,000	12,500,000	3,800,000
1917-18	146,000,000	27,000,000	21,000,000	4,000,000
Total	\$454,000,000	\$95,000,000	\$33,500,000	\$11,500,000

The direct taxes thus amounted to \$33,500,000 + \$4,000,000, or not quite 6 per cent., and the indirect or consumption to \$590,000,000, or 94 per cent. of the whole.

3. Distributing the Burden.

After this rapid outline of the more essential facts as to our war finance, a brief summary of the principles which experience has shown should govern will be in order. Doubtless many of the points noted below will appear obvious and elementary, but experience shows how easily the obvious is overlooked.

The first and fundamental principle to keep in mind is that it is goods and services, not money, that are the prime requisite in waging a great war. It is not a question of how to get a billion dollars in money, but how to get a billion dollars' worth of goods and services where they will be most effective in winning the war. The financial task, important though it is, is only secondary to the task of organizing the nation's resources.

A second fact, more often overlooked, is that these goods and services must come out of the present, not out of stores inherited from the past, nor out of the activity of generations yet to come. The past can help us little in a war of such magnitude as this. The world lives from hand to mouth. Men have been working on this old earth for tens of thousands of years, and yet experts tell us that if production suddenly ceased the world's stocks would last little more than a year. Even our capital equipment is only the equivalent of a few years' total effort. Nor can the future provide the goods and services needed now. The guns, the shells, the blankets, the wheat, produced in 1929 will not help win the battles of 1919. Every bit of human effort, every yard of khaki, every pound of steel that is to count must come out of current production.

Putting the Load on Posterity.

Can we not, then, throw any of the burden of the war upon posterity? Little of our burden. Posterity will have a burden of its own. It will suffer by the loss of millions of the most energetic and promising of the world's workers, by the rapid waste of resources, by the destruction of town and field, and by the cessation during the war of the usual addition to or upkeep of civil capital equipment. It may suffer still further if the outcome of the war is military deadlock, rampant and exclusive nationalism, a Prussianizing of the policy of all states which will mortgage men's labor for long years to come in renewed wars and preparation for wars. It may gain if the outcome of the war is the triumph of real democracy and the achievement of a sane international organization and of co-operation in trade. But whether the net result is that the world in future is worse off or better, however much our

policy and efforts today may influence its fate, very little that will be done in the future can add an ounce to our weight in the scales today. There are only two ways in which we can obtain an increase of present goods at the future's expense—by importing goods from other countries and leaving to posterity the task of paying for them, and by ceasing to make the usual provision for upkeep or repair of capital goods.

Granted, but cannot we make the future share the financial burden? Cannot we by borrowing the money needed compel posterity to bear part of this generation's colossal load? The government may thus postpone its day of reckoning; the nation cannot. The government may choose between paying for the goods it takes by taxes levied today and paying for them by taxes levied tomorrow. The nation must provide the goods today. If we borrowed every cent of the cost of the war, that would simply mean giving future individual creditors the right to recoup themselves from future individual taxpayers. Conceivably loans and taxes might be so distributed that in the future each man would get back in interest just what he paid in taxes. In any case, the next generation will not be repaying this generation; some individuals in 1935 will be paying other individuals in 1935. For every debit there will be a credit. If every bond were burned, the nation would not be (so far as direct consequences go) a cent the richer—or the poorer; taxpayers would gain what bondholders lost. That does not imply that a huge debt is not, as will be noted later, a real burden, a source of social unrest and of serious fiscal problems. It simply means that no fiscal policy we adopt, no financial hocus-pocus, can avert the need of bearing today the costs and sacrifices of the goods necessary for the war. The future cannot aid us, though our policy may harm the future, just as it may distribute very unfairly the burden of the present.*

*Where the goods can be obtained from another country, and paid for by loans for which the next generation is taxed, the burden is shirked thus far. But in a war of the present magnitude, involving nearly every country, this course is possible only in small measure.

Organizing Present Production.

If, then, it is the present that must furnish the needs of war, and furnish them on a scale undreamed of,—myriads of men, mountains of shells, fleets of ships and airplanes, volcanoes of chemicals, colossal stores of food—and if at the same time millions of workers are withdrawn from production, whence are these goods to come? We can get them from allies or neutrals. We can produce them ourselves by calling out the reserves of labor, the women and youths who were spared industrial work, the unemployed, and the leisured classes at opposite ends of our society. We can utilize labor to better advantage, by scientific management, by improved processes, by overcoming under stress the obstacles which employer's inertia or trade union rules had put in the way of speeding up production. Above all, we can cut down consumption, reducing waste in necessities, and transferring labor from non-essential to essential occupations. We can take in the slack of ordinary days, cut out the extravagances that were still more marked a feature of our industrial order than the famine and penury, and devote this surplus to war needs. One thing most emphatically we cannot do—we cannot produce what the state needs for war and at the same time produce all that individuals used to demand for their private consumption. 'Business as usual' may be a good motto for a short war, or for the panicky transition months at the start of a long war, but it has been proved an impossible policy in a war of the present scale and duration.

[How, again, is the government to ensure that the huge and unending stream of war supplies will be provided? In a socialist state, at least on paper, the task would be very simple. The state authorities would merely have to divert state factories and state workmen from one industry to another. There would be no question of profits nor of rising wages or rising prices, nor of loans or taxes.] We are, however, living under a system of regulated individualism. Most of us believe that with all its inequalities and all its evils—evils which must be, can be, and are being lessened—this system works out to greater net advantage to the great majority than socialism would secure. Whether this belief is sound or not, the

system cannot be superseded in the midst of a war. It may be profoundly modified. An awakened patriotism, the recognition of emergency needs, make people ready to acquiesce in a vastly increased measure of state compulsion. Yet the fact remains that there is a limit to the power of such forces, and that the ordinary motives of self-interest and profit-seeking cannot be ignored, particularly as year is added to year.

Compulsion is best applied in negative fashion, in determining what must not be produced or consumed, while the profit-seeking as well as the patriotic motives must be relied on for the positive stimulus, to increase to the utmost the output of what is needed. The state can prohibit the making of whiskey or phonographs or costly silks; it cannot by force make the workmen show energy or the employer develop initiative in making munitions. Russia is a standing proof of the limits of force. Compulsion, then, can best be directed toward lessening the output of non-essentials. Pressure may be exerted on the producer of less essential goods, cutting off his supply of capital by restricting capital issues, cutting off his supply of raw materials by priority orders, cutting off his supply of labor by granting exemption from military service only to men employed in essential industries. It may also be exerted more indirectly on and through the consumer, by compulsory rationing, by prohibiting the importation of certain luxuries, by taxing specific luxuries, and especially by taking from the consumer his surplus purchasing power through loans or taxes. Even with all this done, there remains the need for paying the producer of essentials a price that will cover cost of production and a moderate profit.*

*One phase of compulsion which has been over-emphasized is the fixing of maximum prices. Such a policy may prove effective in a short period, when only the supply of goods already in existence is concerned. Over a longer period, it is necessary to ensure such a profit as will maintain production and keep industry fluid, a task which in practice it is difficult to carry out under a price-fixing regime, in face of the constant shift of the factors determining costs. Fixing maximum prices is merely tinkering with symptoms, an admission that root remedies have been neglected. Prevent that share of the rise of prices which is due to inflation and the failure of the state to tax and of the people to save. Turn

Savings or Inflation.

How, next, is the state to secure the funds required to pay for its war needs? There are two questions involved which are often confused. First, from what source should the funds come, from real savings or from inflated credit? Second, what means should the state adopt for tapping this source—loans or taxes?

Through countless generations men have worked out a mechanism of money and credit for transferring goods and property which has tremendously stimulated progress, though, unfortunately, it is very easily thrown out of gear. There exists at any given time at the disposal of private individuals a great fund of purchasing power which they may use to secure the goods and services they severally desire. This purchasing power may take the form of metallic or paper money, or it may take the form of credit on the books of a bank, which can be utilized by drawing cheques. Now if the state wishes to secure for war purposes one-third of the product of the people's industry, it should at the same time induce or compel the people to part with one-third of this purchasing power. If this is not done, if the state or its banking agents simply create additional purchasing power, new money, then state and individuals will enter the market in competition for the control of industry. Individuals, offering their money for the goods they desire, will seek to keep industry working on these goods. The state, by offering its additional purchasing power, will seek to divert industry to

or attract production into the essential industries. Investigate the organization of each industry (as advocated by the present Dominion Statistician in his Cost of Living report in 1914), laying bare any broad defects or wastes of effort. Remove any monopoly privileges possessed by certain producers. Give publicity to price factors. Then where large profits still are reaped, take the bulk of them for the common good in taxes. There may remain a field within which price-fixing will still be necessary, but it will be very small. Where the supply is relatively fixed and permanent, as in the case of houses, there is clearly room for more price-fixing (that is, rent fixing) than in the case of goods which are rapidly consumed and of which a fresh supply is constantly required. See W. C. Clark, *Should Maximum Prices be Fixed?*, Bulletin No. 27. .

making the goods it needs. With purchasing power increasing faster than production (allowing for a possible increase in production as a whole), prices will rise. Each unit of purchasing power will buy less goods, particularly, of course, as price is a factor both of money and of goods, in those fields where supply of goods is lessening. The mass of the people will be forced by the rise in prices to forego not only luxuries but necessities, and thus in a roundabout, burdensome and incomplete fashion production will be shifted to war essentials. Under such a condition of inflated prices, the chief burden of war rests on the mass of the people, and industry is only imperfectly adapted to war needs.

A crude illustration may be suggested. Suppose that the total production of a community is represented by a million bushels of wheat, and that the people hold a million tickets, each entitling its owner to an equal fraction of the supply. Some hold one ticket, some a hundred. The government of the community wishes to secure one-third of the wheat for its soldiers at war. It has two choices before it. It may induce or compel the people, particularly those who have abundance, to hand over one-third of their tickets, or it may print some hundreds of thousands more tickets. If the latter course is taken, every one who presents a ticket finds that it does not secure as much wheat as before, and the poor man whose one ticket barely kept him alive suffers most from the reduction.

The old way in which inflation was brought about was by the issue of inconvertible paper money. In the present war Russia relied mainly on this dangerously easy method of finance. Germany followed far on the same primrose path, and even France, with its traditions of sound financing, has had recourse to it to an extraordinary extent. The British government adopted it to a limited degree in the issue of the currency notes. The United States, warned by its greenback follies in the Civil War, has steered clear. Canada started down the slippery slope at the outbreak of the war, but fortunately halted after the issue of some \$31,000,000 in Dominion notes, a measure of inflation which may be defended as moderate, a necessary priming of the pump.

A second and more subtle method of inflation is by the

undue expansion of bank credits, in those countries in which deposits subject to cheque constitute the main form of purchasing power. This may come about by the direct bank purchase of government securities, or by bank loans to individuals to buy securities. Where the increase in bank credit represents a real increase in goods produced and business done, or where loans are temporary advances to be repaid shortly out of real savings, there is little danger. But where, on top of ordinary credit, unlimited additional credit is offered for war purposes, inflation is inevitable. Germany has notoriously relied on dangerous pyramiding methods. English practice has been more conservative, but has still led to serious inflation. In the United States, the possibilities of expansion due to large gold imports, lessened bank reserve requirements, Federal Reserve rediscounting facilities, and the setting up of the War Finance Corporation, have awakened much alarm. The situation has been well summed up by A. C. Miller, of the Federal Reserve Board:

The doctrine set forth in the famous English Bullion Report, which came in the midst of the controversies growing out of the management of the Bank of England's circulation during the Napoleonic wars, and whose truth has been attested by the experience of every modern nation, is that two things are necessary to protect a system of banking currency and credit against the danger of undue expansion. One of these is the *maintenance of adequate reserves*; the other is the *maintenance of adequate liquidity of investment*. By liquid investments is meant bank paper which liquidates itself in short periods of time out of the proceeds of the transactions which have given rise to the paper. . . . Self-liquidating paper being, therefore, paper which is connected with productive operations in industry, it follows that the same banking transaction which gives rise to an increase in the supply of purchasing media through the expansion of banking credit, also gives rise to an increase in the supply of purchaseable goods through the assistance rendered the producer. But

when a bank invests its credit in the purchase of government bonds which are issued for the purposes of war—for operations that result not in the production but in the consumption and destruction of goods—we have an altogether different situation. There has taken place an addition to the volume of outstanding banking credit and purchasing media with little additional in the way of goods to offset it on the shelves of the shop-keeper or the warehouse of the manufacturer. . . . But since prices depend upon the ratio existing between the supply of purchasing power in terms of money, and the supply of purchaseable resources in the form of consumable goods, it follows that an increase of bank resources not offset somewhere in the economic process by an increase of economic resources in the form of consumable goods, must and will lead to a rise in prices.

To avert this danger of deposit inflation, two courses may be followed. The negative course is to limit the use of credit for ordinary purposes, in order to set it free for war needs. The Canadian Finance department has done good work in this direction by discouraging investment in outside securities and by forbidding issue of domestic securities without special permission. Further necessary steps on the part of the banks are foreshadowed in a notable circular issued by the President of the Canadian Bankers' Association to his fellow-bankers, adapted from a similar warning from the Federal Reserve Board, and beginning as follows:

It is clear that if the war requirements of the Government are to be financed without due expansion of banking credits, not only must there be some reduction of existing credits, but there will have to be applied a rigid check upon the further expansion of credit in directions not clearly essential for the prosecution of the war and for the health and necessary comfort of the people. *It is no more possible to superimpose upon the volume of pre-war credits the immense volume of additional credit required by the Government for war purposes than to superimpose upon the volume of pre-war*

production of goods the immense volume of additional goods required by the Government to prosecute the war. . . . Our best hope of avoiding competition between the Government and its citizens for credit, money, labour and material, which can only result in credit and price inflation and higher costs of living, is saving.

The positive course is to stimulate in every way the homely quality of thrift, to induce individuals to lessen their ordinary consumption and turn over the savings to the government as loan or tax. The success of the fourth or Victory loan, to which there were 820,000 subscribers, and the increase of \$400,000,000 in savings (or rather, interest-bearing) deposits in the banks during the war, show that a considerable measure of success has been attained so far as loans are concerned, though there is a different story to tell when it comes to taxes. In the forthcoming loans, a still greater effort must be made to induce people who have not hitherto saved or have sought other investments, to turn over their surplus purchasing power to the state.

War Savings Stamps.

The most conspicuous short-coming in this branch of Canadian war finance has been the failure to utilize the instrument of stimulating and collecting small savings which Great Britain and the United States have found of the utmost value—War Savings Stamps. Under the system adopted in the United States, which has profited by British experience, certificates are issued in the form of a large stamp, entitling the bearer to receive \$5.00 on January 2, 1923, and sold for \$4.12 on January 2, 1918, and for one cent more each month following—that is, yielding four per cent. interest, compounded quarterly. It may be cashed in the meantime, on due notice, at a price to yield about three per cent. simple interest. To assist in accumulating the amount of the large stamp, the government issues a small thrift stamp sold for 25 cents, to be pasted on a thrift card and exchanged for the large stamp when filled. The stamps are on sale everywhere and an aggressive voluntary organization thrusts them upon the spend-thrift at every turn. The plan has worked admirably. Its

chief value is not merely that in eight months it has raised, including payments pledged, \$1,600,000,000 from 35,000,000 persons, of which over \$300,000,000 has already been paid in, but that the money thus secured is genuinely saved, the result of self-denial, not the easy product of bank accommodation. As the man in control, Frank Vanderlip, president of the largest American bank, and one of the leading financiers of the country, has put it: "The thing that it has been necessary to get into the minds of the American people is that they are getting in the way of equipping the army if they compete with the Government for labor and material by buying unnecessary things. . . It was absolutely essential that the people should comprehend the doctrine of goods and services, should see that there was not labor and material enough to gratify all their wants, and leave a remainder sufficient to permit the Government to equip the army. That was the main thing the War Savings movement was intended to accomplish. What it might accomplish in the way of financial aid to the Government was secondary and uncertain." Both aims have been achieved to a surprising degree.

This plan has repeatedly been urged upon the Canadian Department of Finance in the past two years, but thus far in vain. It is understood that as soon as the next Victory Loan campaign is over, a W. S. S. scheme will be launched, under the efficient control of Sir H. B. Ames. It is greatly to be hoped that even at this late day this will be done. There is no other device known to us so well calculated to promote genuine saving during the war, and to encourage permanent habits of thrift. The objection that such stamps would become media of exchange and assist in inflation is baseless; the effect is absolutely the contrary, checking the inflation that comes from over-reliance upon bank credit. The claim that our War Savings Certificates meet the need is not well founded. These Certificates are sold through the banks and post-offices to such people as ask for them; the War Savings Stamps in the United States are sold everywhere by an organized aggressive and at the same time inexpensive campaign. The Certificates are sold only in units of \$10 or more; in the United States 25 cent thrift stamps are sold to apply on \$5 certificates. In a year and

a half \$12,500,000 Certificates were sold in Canada; in eight months \$1,600,000,000 W. S. S. were sold or pledged in the United States. Experience has further shown that a War Savings Stamps campaign need not interfere with the larger loan campaign, but rather assists it, making saving a habit.

Loans or Taxes.

Assuming, then, that the source of funds should be savings rather than inflated credit, what of the means of tapping this source—loans or taxes? Should the state take or should it borrow?

Why not raise all the funds needed by taxation? If the present must provide all the goods used, why can it not provide all the funds to pay for them? Only the surplus of goods over civil consumption can be purchased for war needs; why not purchase this surplus of goods with the surplus of funds over that required to finance civil needs? Such a policy is conceivable, but is hardly practicable. It would mean too drastic a revolution in industry. It would discourage production. It would lead to concealment and evasion. Borrowing is an indispensable policy in great wars.

Why not, then, raise all the funds needed by borrowing? If the present cannot, by borrowing, throw its burden on the future, why need the future complain? Because taxes are essential for overwhelming reasons:

(1) *To maintain credit.* Unless at least sufficient taxes are levied to cover interest and provide a sinking fund, creditors will cease to have faith in the likelihood of repayment, and loans will issue at ever larger discounts.

(2) *To prevent inflation and divert industry to war needs.* Loans as well as taxes may come out of savings, and taxpayers, particularly corporations which have reinvested profits in the business, may borrow to pay taxes. Yet there is an important psychological difference in the effects: to tax a man is much more likely to lead him to retrench than to give him a bond which makes him feel at least as rich as before.

(3) *To tap sources not available after the war.* When the country is in peril and men at the front are giving their tithes than in peace times. Further, there are special sources of

taxation, such as war profits, which should be largely drawn upon, in equity and to avert popular discontent.

(4) *To ensure that the well-to-do will pay an adequate share.* The heavier the taxes levied during war, the greater the likelihood that they will be progressive, since the limit is soon reached in the case of the people with a bare surplus over necessities, and all the balance must come from those who have a large surplus above necessities.

(5) *To avert serious fiscal difficulties facing the Governments of the future.* Even if, as is true, practically every cent paid in taxes to meet war loans will be paid back in interest, it is not merely a matter of book-keeping. To get into the treasury the huge taxes required to meet the interest on to-day's borrowings, and to provide for to-morrow's reconstruction needs, will be a task of tremendous administrative difficulty, particularly if periods of depression come. If soldiers come back from the front to find that after doing the fighting they must also bear the burden of paying off the debt, the way of the government of the day will be hard. Of course, as the Tammany statesman remarked, What did posterity, or to-morrow's government, ever do for me?

It is, then, essential that a large proportion of the cost of the war should be met out of current taxation. What has Canada done, particularly in comparison with the United Kingdom and the United States? A summary statement follows:—

*Comparison of Current Revenue applied to Principal of War cost,
United Kingdom, United States, and Canada.*

CANADA (Millions of dollars).

	1914-15	1915-16	1916-17	1917-18	1914-18
I. Cost of War, expenditure on					
Canadian account	60.7	166.2	306.5	343.8	877
Surplus (1) of revenue over actual civil budget	—54	—1	+41	+26	+12
Surplus (2) of revenue over 1913-14 civil budget (186,000,000)	—53	—14	+46	+75	+54
Proportion of direct cost of war met by Surplus (1)	def.	def.	13%	11%	1.3%
Proportion of direct cost of war met by Surplus (2)	def.	def.	15%	21%	6.1%

II. Total Canadian expenditures,					
civil and military	248	339	498	578	1663
Total current revenue	133	172	232	261	798
Proportion of total expenditures					
paid out of current revenue....	53%	50%	46%	46%	48%

III. Ratio borne by average yearly surplus revenue applicable during the war on the war principal, to the pre-war yearly revenue
 $=14/163=1/12$.

UNITED KINGDOM. (millions of pounds).

	1914-15	1915-16	1916-17	1917-18	1914-18
I. Cost of War, expenditure on					
United Kingdom account only..	416	1068	1418	1914	4816
Surplus (1) of revenue over actual civil budget .....	....	....	....	....	....
Surplus (2) of revenue over 1913-14 total budget	38	138	275	509	960
Proportion of direct cost of war met by Surplus (1) .....	....	....	....	....	....
Proportion of direct cost of war met by Surplus (2)	9.1%	12.9%	19.4%	26.5%	20%
II. Total U.K. expenditures, civil and military, omitting loans to					
Allies	508	1243	1648	2201	5600
Total current revenue	226	336	573	707	1842
Proportion of total direct exp. paid out of current revenue....	44%	27%	35%	32%	33%

III. Ratio borne by average yearly surplus revenue, during the war, and applicable to war principal, to the average pre-war yearly revenue
 $=240/197=6/5$.

UNITED STATES (millions of dollars).

	1917-18 (yr. end. June 30)	estimate 1918-19 (yr. end. June 30)
I. Cost of war, expenditure on U.S. account only	6,550	17,000
Surplus (1) of revenue over actual civil budget . . . . .	....	.....
Surplus (2) of revenue over 1915-16 total budget	2,870	7,100
Proportion of direct cost of war met by Surplus (2)	44%	42%

II. Total direct U.S. expenditures, civil

and military	7,550	18,250
Total current revenue	3,941	8,182
Proportion of total direct expenditure paid out of current revenue	52%	45%

III. Ratio borne by average yearly surplus revenue during the war, and applicable to war principal, to the average pre-war yearly revenue
 $=4875/1153=4\frac{1}{2}\%$.

. Much depends upon the country with which we compare our own effort. If we turn to France, war-harried and robbed of vital provinces, or to Italy, isolated industrially and rent by faction, or to Australia, industrially undeveloped and cut off from world markets by lack of ships, or to Germany, confident at first of meeting the cost of the war out of indemnities, our record shows up well. If, however, we turn to countries which like ourselves, have been free from war at home and have been able to expand industrially, such as the United States and Great Britain, there is a different story to tell. Here again, much depends upon the basis taken for comparison. If we ask what proportion of the total direct war-time expenditure (including both civil and military outlays, but excluding loans to Allies), has been met out of current revenue, we find that Canada, like the United States, has met nearly one-half, while the United Kingdom has met only one-third. But this favorable comparison is due to the fact that our war-time expenditure bears a much smaller proportion to our peace-time expenditure than in the case of Great Britain: we have spent on the war, to March 31, 1918, less than five times the sum we used to spend every year in peace-time, while Britain has spent twenty-five times its peace outlay. As to the United States, both its total expenditure and its total revenues have multiplied much more rapidly than ours. If, then, we ask the more pertinent question, how much surplus revenue have we raised during war-time over and above the civil expenditure of each year (or, since these figures are not available for all three countries, how much over and above the total expenditure of the last year before the war), we have a very different situation. In the four years Canada has met only 6% (or on the first basis of computation 1.3 per cent.) of the direct principal cost of the

war out of surplus revenue, as against 20% met by the United Kingdom; while the United States has met the extraordinary proportion of 44% the first year and proposes to meet 42% this year. The redeeming feature in our case is that in the last two years our showing is very much better than in the first two. Again, we get an idea of comparative effort when we note that the average surplus over civil expenditure during each year of the war is, in Canada's case 1/12 of a year's peace-time revenue, in Great Britain's, 1 1/5 times, and in the case of the United States, 4 1/5 times a pre-war year's revenue. Clearly, even after due allowance is made for our less developed industrial and financial status, we have a very long way to go before we can measure up to our senior partners.

Taxes on Wealth or on Consumption?

We have, then, not paid out of current revenue that proportion of the total war-cost which the fiscal and social considerations noted above made advisable and which our war-time prosperity would have made possible. In this failure we have many companions. In the further requisite that a large proportion of whatever revenue is raised should come from taxes levied directly on property or income, rather than on expenditure, we have failed more signally, and with fewer fellow-sinners to give us countenance.

A large proportion of taxes levied directly on property or income is essential for three plain reasons. Taxes based on consumption, so far as they are levied on articles used mainly by the masses, as is usually the case, take a much larger proportion of the income of the man with \$1000 a year, who must spend \$800 to keep alive, than of the income of the man with \$100,000 a year. Taxes, such as tariff duties, so far as levied on machinery, materials, or semi-finished goods, raise costs of production all along the line, and put home industry at a disadvantage in world markets, at least in peace-time, when competitive conditions reign. Taxes levied directly, again, are essential to bring home to the taxpayer the actual facts as to the costs of government. On the other hand, some proportion of tariff and excise taxes is desirable in order to make the man of moderate income who might not be reached

by an income-tax, pay his share, and to attach a penalty to certain luxurious kinds of consumption.*

In the following table a comparison is made of the proportions of direct and indirect taxes in the budget of the United Kingdom, the United States and Canada:

UNITED KINGDOM

Year	<i>Total Revenue from Taxes</i>	<i>Taxes on Property and Income</i>		<i>Taxes on Consumption</i>	
		Amount	Per Cent	Amount	Per Cent
1913-14	£163,000,000	£78,000,000	48	£85,000,000	52
1914-15	190,000,000	101,000,000	53	89,000,000	47
1915-16	291,000,000	163,000,000	56	128,000,000	44
1916-17	514,000,000	379,000,000	74	135,000,000	36
1917-18	613,000,000	495,000,000	81	118,000,000	19

CANADA

1913-14	\$127,000,000	.....	.....	\$127,000,000	100
1914-15	97,000,000	.....	.....	97,000,000	100
1915-16	124,600,000	1,200,000	1	123,400,000	99
1916-17	174,700,000	13,800,000	8	160,900,000	92
1917-18	198,000,000	22,300,000	11	175,700,000	89

UNITED STATES

1916-16	\$ 726,000,000	\$ 125,000,000	17	\$ 601,000,000	83
1917-18	4,116,000,000	3,321,000,000	80	795,000,000	20
1918-19 (est.)	8,357,000,000	5,756,000,000	69	2,601,000,000	31

In the face of such figures, comment is needless. Fortunately, a beginning has been made in Canada toward a more adequate fiscal system by the imposition of excess profits and income taxes.

More taxation, less borrowing; more direct, less indirect taxation; to these may be added a third canon—a discrimination between 'earned' and 'unearned' income.

Take three men each receiving and spending \$10,000 a year. A is the owner of \$200,000 worth of five per cent bonds, bought from his own earlier savings or inherited. B receives the same income from the prosperous but risky business which

*The classification into taxes on property and income taxes on consumption is preferable to the more customary classification into direct taxes and indirect taxes. The important question is whether the tax is made proportional to a man's wealth or proportional to his expenditure on certain goods, not whether a tax on consumption is collected from the sellers or from the buyer.

he is actively directing. C is a salaried or professional man with the same net income. Should all be taxed at the same rate on their income? When they die, A's principal will be intact; C's estate will have no further earning power, while B's estate will be of uncertain value. Consideration of this fact has led Great Britain and other countries to impose a lower tax on earned than on unearned income. There is less occasion for making the distinction in a country like Canada, where unearned income is relatively small, but the need exists.

Exemption of War Loan Bonds from Taxation.

One phase of taxation policy has lately received much attention—the question of taxing or exempting the income from war loan bonds.

Certainly the considerations just reviewed seem to tell against exemption. We need more taxes. We need more direct taxes. We need to discriminate in favor of earned, not of unearned, incomes. The political danger of creating a privileged class is also not to be ignored. What, then, is to be said in favor of exemption? The one argument, and it is, if valid, an overwhelming one, is that the exemption privilege was and is necessary to attract sufficient subscriptions, and that the alternative policy of offering a higher rate of interest would have imposed a greater burden on the treasury than any income taxes levied on the bond-income would have offset.

So far as Canadian loans floated in the United States are concerned, this contention is undoubtedly valid. A foreign investor, without any means of controlling the fiscal policy of Canada, would naturally be shy about putting his money into bonds, the interest from which might be absorbed to a large and uncertain degree by Canadian taxes. Yet giving exemption on New York issues did not in the least entail giving exemption on issues floated at home. Great Britain has exempted every loan floated in the United States from British taxation, while at the very same time it was making issues floated in Britain taxable.

Canadian loans floated at home must then be judged by Canadian conditions. It is of course necessary to study them in the light of conditions as they were and were known at the

time; it is easier to-day than it was in 1915 and 1916 to be optimistic about Canada's loan-absorbing power (though before our first domestic loan, Britain had issued loans to which 1 in 60 of the people subscribed, Germany 1 in 25 and France 1 in 12). Any criticism of special phases of the financial administration should, further, be made subject to full recognition of the ability and success of the loan campaign as a whole.

The valid argument for exemption is that investors will offer more (or take a lower interest-return) for a tax-exempt loan, and thus bring so much more into the treasury. How much more will they offer? Approximately the capitalized value of future tax-exemptions. But at what would that value be computed when our first three domestic loans were being floated? At precious little more than zero. At the very time that the Minister of Finance was issuing loans exempt from any income or other federal tax thereafter to be imposed, he was proving repeatedly and convincingly, heaping up argument upon argument, that no income tax should be imposed in Canada, unless as a last dire resort. If there was to be no tax, the exemption would be of no value, and the canny capitalist for whom the Minister was angling would not offer something for nothing. The policy adopted did not even secure present advantage at the cost of future loss; it sacrificed both present and future advantages. Further, even if low income taxes had existed or been foreshadowed, and if these had been allowed for in the price of the loan, any later and unexpected increase in income tax rates is not thus balanced, and adds to the advantage of the holder without any gain to the treasury.

It is true that the supreme necessity was, and is, to raise the funds necessary for our vast war needs. But was the exemption privilege essential to this end? It was and is possible to raise much more by taxation, and by War Savings Stamps, than has been done. It was possible to create a market for our own war loans by restricting other capital issues and discouraging investment in loans abroad, as the Minister of Finance has well done. And as to ordinary loans, there are many factors making for success aside from tax-exemption privileges—patriotism, organization, rate, and conversion privileges. Compare the Victory loans of Canada and the Lib-

erty loans of the United States.* It is true the United States was fresh and unprecedentedly prosperous, while Canada had borne the brunt of war for many months; on the other hand, the republic was planning a much more drastic tax programme. Patriotism counts in the success of a loan—not with all men, but with most; and surely that factor is as great in Canada as in the United States; it doesn't require a miraculous amount of patriotism to be induced to accept $5\frac{1}{2}$ per cent for one's money on absolutely safe security. The rate counts, and Canada offered over $5\frac{1}{2}$ while the United States offered $4\frac{1}{4}$. The privilege of conversion into later loans issued at higher rates of interest counts: our first and fourth loans were made convertible at issue price, while the second and third were given this privilege later; the bonds of the first United States loan were convertible, of the second convertible upon conditions, and of the third not convertible. Organization counts, particularly when it is desired to reach the mass of people who have not been in the habit of buying bonds. For organization, both voluntary and paid service is needed. Banks, bond houses, and salesmen must be compensated for their work. When we awoke to the need of making the loans a popular success—as usual, not following the example of Great Britain until it had been endorsed by the United States—we certainly made ample provision for greasing the wheels. We spent $1\frac{1}{4}\%$ of the amount subscribed to our last loan in payment of such services (.62 per cent. to bond houses and salesmen and for advertising, and the balance to the banks for their services, including cashing coupons at par); the United States law fixes a maximum cost of $\frac{1}{5}$ of 1 per cent. for floating any loan. Doubtless our outlay was well spent and well earned, since in a scattered country like Canada organization and publicity are particularly necessary, but it should have brought forth an energy that

*All our loans have been tax-exempt. The first United States Liberty loan was exempt except from inheritance taxes; the second and third, exempt except from inheritance, income surtax, excess profits and profits taxes, while bonds up to \$5,000 principal were also exempt from the latter taxes. Lately, in view of the swinging income taxes imposed and proposed, Congress has increased this restricted exemption to \$30,000 for the Fourth Loan, and to a total of \$50,000 for previous issues.

would make up many times for any lack of the tax-exemption privilege.

When, however, one tax-exempt loan after another has been floated, a difficult situation undoubtedly arises. There is force in the contention of the Minister of Finance that wealthy people "can buy on the open market what they require from our tax-free issues now outstanding in Canada or the United States. Will the average investor buy and continue to hold taxable bonds when he can obtain tax-free bonds at the same or a slightly increased price on the open market? Would not a taxable issue patriotically subscribed gravitate to a discount through subsequent selling by such investors?" Probably,—though 'a discount' may not necessarily mean less than par: it might mean par, while exempt bonds bore a premium.

We cannot for a moment think of repudiating the pledge to exempt the bonds already issued. We must pay for our failure to impose an income tax early in the war. It is, however, possible, if not to make the next loans wholly taxable, at least to impose a limit on the amount in any investor's holding that will be so exempt, or to make the new bonds liable for income surtax.

4. *The Future.*

The civil budget for 1918-19 amounts to \$230,000,000. This includes \$78,000,000 for debt charges and \$16,000,000 for pensions. If the war should end in August, 1919, these two items would probably reach \$150,000,000. Other peace-time expenditure, including provision for railway obligations, construction of deferred public works, and military and naval outlay, will likely run at least another \$150,000,000. The Finance Minister of the future will have to provide at least \$300,000,000 a year; it may easily be \$400,000,000. That will mean half as much revenue again as is being obtained this year. Whence is it to come?

The old-fashioned way of making ends meet is to cut down expenses. It will be difficult to adopt in Canada. There will be countless urgent and worthy causes calling for aid. There will, as before, be insistent assaults on the treasury from classes or individuals who assume that the country owes them a living. To spend generously without waste, to have faith in

the future without too greatly mortgaging that future, will be a hard task. Yet it must be faced.

Economy is a question of details. Outsiders know little of the working of government departments, and can offer no suggestions of value. Prudent business administrators may do much. Parliament can do more, as Great Britain's experience suggests. Great Britain, like Canada, has had an able finance ministry, a system of Treasury supervision, a vigilant auditor-general. Yet the special House of Commons Committee on National Expenditures has recently uncovered extraordinary waste and incompetence in many fields. Anyone who reads the dozen reports of this Committee must recognize how helpful a similar body might be in Canada. True, in the past we have had investigating Committees in which Opposition members strove solely to blacken the Government and Government members strove solely to block the Opposition. Perhaps we can do better now. In any event, Parliament, which in Canada as elsewhere, is rapidly becoming a rubber stamp in the hands of the Cabinet, would do well to seek a more active control, or at least survey of administration. There is no better place to begin than in the supervision of expenditure.

Whatever economies are effected, increased revenue will doubtless be required. Whence is it to come, from the national domain and public industries, or from tariff, or excise, or income, or excess profits, or still other taxes?

From the public domain, the federal Government can expect little revenue, as the provinces possess or will possess the bulk of the Crown lands. Railways and other public works are likely to be for many years a source of expense rather than of income.

The tariff must continue to provide a very large share of our revenue, though the decline of our munitions business, based largely on imports of semi-finished material from the United States, will bring a serious reduction for a time. There has been endless discussion of the theory of protection versus free trade, and there will be more, though the aspect of the controversy will be changed. There has, however, been little consideration of the question of fact,—which of the duties imposed by our tariff are protective in effect, and which are

revenue-bearing? In a later *Bulletin*, an attempt will be made to deal with this question.

Excise taxes on articles produced within the country will also long remain, but will probably be of secondary importance. The revenue from liquors will soon dwindle. The rates levied on tobacco cannot be greatly increased without lessening the yield. The luxury taxes on jewellery, musical instruments, and patent medicines are good war-time expedients, but of more doubtful permanent value. Stamp taxes will probably be retained and extended. On the whole, this branch of the revenue will do well if it keeps up to the pre-war level.

It is chiefly to the income-tax that we must look for the needed increase in federal revenue. A good beginning has been made, in the law passed in 1917 and amended in 1918. As the table over the page shows, there is still room for increase before we reach the British or even the United States levels. Unofficial reports from Ottawa put the probable yield from the income tax in 1918 at \$15,000,000, a decided improvement over the \$2,000,000 forecast in the Budget Speech of 1916, when the proposal to establish such a tax was rejected, but still far from comparing with the British or United States yields given in the second table over the page.* Any increase in rates, however, must be gradual, though there need be no limit to improvements in administration. Too rapid increases in the initial stages, when the administrative machinery is being set up, would make the task of collection difficult. Aside from changes in the rate, differentiation between earned and unearned incomes is the main point to consider. An amendment to cancel the present double exemption granted to both husband and wife possessing independent incomes may be expected. The administration would be facilitated if simple official booklets were issued and distributed widely, explaining in concrete detail the provisions of the Act and the regulations since adopted. There seems need, also, for an increase in the higher administrative staff. The Commissioner of Taxation

*Canadian taxpayers are permitted to deduct any tax payable under the Business Profits War Tax Act from their income tax; if, as is usual, the Business Profits tax is the greater, it is the only one payable.

Income Taxes levied upon Specified Incomes of married persons, with no dependents, in the United Kingdom, United States and Canada.

	UNITED KINGDOM				UNITED STATES				CANADA			
	1918 law				1918 House Bill				1917 Act*			
	Income	Unearned Incomes	Earned Incomes		1917	1918 House Bill			Amount	Rate %	Amount	Rate %
	Amount	Rate %	Amount	Rate %	Amount	Rate %	Amount	Rate %	\$	....	\$	....
\$ 2,500	281.25	11.25	\$ 210.94	8.44	10	.40	30	1.20				.40
3,000	445.31	14.84	356.25	11.87	20	.67	60	2.00			20	.67
4,000	726.56	18.16	581.25	14.53	46	1.00	120	3.00			60	1.50
5,000	937.50	18.75	750.00	15.00	80	1.60	180	3.60			100	2.00
6,000	1,350.00	22.50	1,125.00	18.75	130	2.16	260	4.33			140	2.33
10,000	2,625.00	26.25	2,250.00	22.50	355	3.55	845	8.45			392	3.92
20,000	6,812.50	34.06	6,812.50	34.06	1,180	5.90	2,895	14.48			1,382	6.91
30,000	11,187.50	37.29	11,187.50	37.29	2,380	5.90	5,595	18.65			2,702	9.01
50,000	20,937	41.88	20,937	41.88	5,180	10.36	12,495	24.99			5,782	11.56
100,000	47,187	47.19	47,187	47.19	16,180	16.18	39,095	39.10			17,607	17.61
200,000	99,687	49.84	99,687	49.84	49,180	24.59	101,095	50.55			50,957	25.48
500,000	257,187	51.44	257,187	51.44	192,680	38.54	297,095	59.42			195,407	39.08
1,000,000	519,687.	51.97	519,687	51.97	475,180	47.52	647,095	64.71			499,157	49.92

(Mainly from Report of Ways and Means Committee, H. of R., Sept. 3, 1918.)

*Levied in 1918 on 1917 incomes. †Levied in 1919 on 1918 incomes.

Amount of Income Taxes Collected in the United Kingdom, the United States, and Canada, during the fiscal years stated.

	1917-18	1918-19 est.
United Kingdom	\$1,166,000,000	\$1,415,000,000
United States, on individuals	930,000,000	1,482,000,000
United States, on corporations	526,000,000	894,000,000
Total.....	1,456,000,000	2,376,000,000
Canada	0	15,000,000

has proved his efficiency in connection with the Business Profits Tax, and also his acceptability to the taxpayers concerned, but the growth of the work of the Department requires more men of first-rate business capacity if the work is to be pushed effectively.

A question for the future is the possibility of arrangements between the Dominion and the provinces by which any province might secure revenue by levying so many additional mills on the income as fixed by Dominion assessment. Under such a plan, the yield from inheritance taxes might also be divided. As to taxes on land values or, better, on unearned increment of land values, for many reasons these are better levied by the province and municipality than by the federal government—notably because of the existence in some districts of local taxes on these bases now, and because of the difficulty of securing uniformity of assessment over the whole Dominion.*

The other important form of direct taxation in force is the tax on business profits.

In the United Kingdom this tax is strictly a tax on war-time profits. The government now takes 80 per cent of all profits in excess of those received before the war. In Canada and the United States the tax is based rather on the excess above a given return on capital. For war-time purposes the British method seems much sounder. The case has been admirably summed up by Secretary McAdoo in urging a change in the present United States tax:

A war profits tax finds its sanction in the conviction of all patriotic men, of whatever economic or political school, that no one should profit largely by the war. The excess profits tax must rest upon the wholly indefensible notion that it is a function of taxation to bring all profits down to one level with relation to the amount of capital invested, and to deprive industry, foresight and sagacity of their fruits. The excess profits tax exempts capital, and burdens brains, ability and energy.

*See *Federal Finance*, I, pp. 24-27.

The excess profits tax falls less heavily on big business than on small business, because big business is generally over-capitalized and small businesses are often under-capitalized.

The war profits tax would tax all war profits at one high rate. The excess profits tax does, and for safety must, tax all excess profits at lower and graduated rates. Any graduated tax upon corporations is indefensible in theory, for corporations are only aggregations of individuals, and by such a tax the numerous small stockholders of a great corporation may be taxed at a higher rate than the very wealthy stockholders of a relatively smaller corporation.

It may not be practicable now to change the basis of our profits tax, though probably nothing that could be done would have such salutary indirect results in quieting the widespread unrest occasioned by huge war-time profits. The ending of the war will end the possibility of a war profits tax.. But should the excess profits tax be made a permanent feature of after-war finance, as many in the United States are already urging?

In its favor there is one strong but not conclusive argument—the ease of collection. It is also urged that such a tax ensures the country sharing in abnormal profits due to the country's silent partnership or to monopoly privileges. This is desirable, but it does not follow that such sharing can be more fairly secured through a tax on business profits than by a tax on income, nor can we be satisfied with a system which allows monopoly to flourish and then merely shares in the loot.

One weighty argument against a tax on the profits of a corporation is that given by Secretary McAdoo. Such a tax may bear no relation to the tax-paying powers of the shareholders, as men of moderate incomes may have shares in a flourishing business, and men of large incomes shares in a small business. But the issue is more fundamental. The socialist is logical in urging confiscation and the abolition of private profit as an incentive to industry. But those who prefer a system of regulated individualism must consider the effects of

such a method of taxation. The effect must be to put a penalty upon energy and initiative, to discourage pioneering, to stereotype industry. Would the English cotton industry, the American motor-car industry, the iron and steel industry, ever have reached their present tremendous development if the possibility of high profits had not stimulated investment and compensated risk? High profits are the premium society awards to industrial pioneers. They do not mean high prices, but in the end much lower prices. Profits go to the men who can introduce better methods, can organize more efficiently, can seize opportunities more quickly than their fellows. (Of course they go also to men who can overwork and underpay their employees, or gouge investors, or buy monopoly privileges. But it is the business of a society such as ours, avoiding alike laissez faire and socialism, to put down vigorously such anti-social methods of profit-making, while giving a free hand to activities in which individual advantage broadly coincides with social advantage). Not only are high profits, fairly earned, necessary to stimulate industry in the initial stages; they are serviceable in building it up. In the average plant, all 'profits' are not distributed to the owners; the bulk usually goes back into the business, with the hope of greater gains later. Run over the roll of industry and note how many have been built up from very small beginnings by reinvestment of profits, and then consider where Canada or the western world would be if it had been made a crime to earn more than eight per cent. I recall a graphic phrase of a witness many years ago, before a government committee, speaking of Canadian implement manufacturers: "Every man jack of them has come up from five dollars." Not many would come up under a permanent excess profits requirement which levelled down all returns.

It does not for one minute follow that such profits should escape taxation. When the profits are eventually drawn, then they should be levied on, and stiffly levied, by the income tax, while the capital value of the investment will be caught by the inheritance tax. It is not a question of letting profits escape; it is simply a question when to collect the eggs, and how many to leave for hatching, a question of how and when taxes may best be imposed in order not only to secure a large present

revenue but also to ensure the growth and prosperity of the industries from which the revenues of the future are to come.


The financial prospect facing us is serious but in no measure hopeless. For a country of great resources, unravaged by war, our burdens will be bearable, particularly in comparison with the load that Europe will carry.* The war has made us realize the immense latent reserves a nation possesses, the unused forces of labor, the added strength that organization and education can yield. The root of the matter is to get more people and more efficient people. If we can put foresight in place of drifting, and team-play in place of class and race and sectional wrangling, there is no reason why we cannot not merely carry the burdens of war but grapple with the greater tasks of peace, in the effort to enable Canada to take its full share in the work of the world and to make our country in reality a land of freedom and equal opportunity, a land where every man and woman among us will have a fair chance to share in the decencies and comforts and the possibilities of development that have hitherto been restricted to the few.

O. D. SKELTON.

*If the war ends next summer, the United Kingdom will have to provide, as interest and sinking fund, a sum about twice as great as its whole pre-war expenditure; Germany, aside from any compensation payments, about three times; Canada, about two-thirds a year's expenditure.

- No. 22, The Royal Disallowance in Massachusetts, by A. G. Dorland.
- No. 23, The Language Issue in Canada; Notes on the Language Issue Abroad, by O. D. Skelton.
- No. 24, The Neutralization of States, by F. W. Baumgartner.
- No. 25, The Neutralization of States, by F. W. Baumgartner.
- No. 26, Profit-Sharing and Producers' Co-operation in Canada, by H. Michell.
- No. 27, Should Maximum Prices Prevail? by W. C. Clark. Canada, by Walter Sage.
- No. 28, Sir George Arthur and His Administration of Upper
- No. 29, Canadian Federal Finance—II, by O. D. Skelton.

Date Due

OC 28			
LIBRARY			
T. J. BATA			
MAR 10			
LIBRARY		JUN - 2 1977	
T. J. BATA			
MAR 30 1971			
		APR 29 1987	
NOV 28 1991			
NOV 2 1987			
NOV 22 1993		APR 21 1997	
NOV 19 1988			
		DEC 10 1998	
		DEC 02 1998	
PRINTED IN U. S. A.		CAT. NO. 23233	

HJ 793 .S5 pt. 2
Skelton, Oscar Douglas, 1
Canadian federal finance. II

010101 000



0 1163 0070107 9
TRENT UNIVERSITY

HJ793 .S5 pt.2

Skelton, Oscar Douglas

...Canadian federal finance. II

DATE

ISSUED TO

005866

